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La Corporation de développement des investissements du Canada.

92-06958/

Contents

Report to the Minister	3
Directors and Management	6
Canadair Limited	7
Eldorado Nuclear Limited	8
Teleglobe Canada	9
Massey-Ferguson Limited	10
Financial Statements	
Canada Development Investment Corporation	13
Canadair Limited	25
The de Havilland Aircraft of Canada, Limited	41
Eldorado Nuclear Limited	55

CANADA DEVELOPMENT INVESTMENT CORPORATION

The Honourable Sinclair McKnight Stevens, P.C., M.P.
Minister of Regional Industrial Expansion

Sir,

Responding to the mandate provided to Canada Development Investment Corporation in late 1984, the sale of The de Havilland Aircraft of Canada, Limited to The Boeing Company was negotiated during 1985 and completed after the end of the year. In addition, the majority of the government's shares of Canada Development Corporation, for which CDIC is responsible, were sold by means of installment receipts during 1985.

The de Havilland Aircraft of Canada, Limited

CDIC and its financial advisors contacted 134 interested parties in order to identify potential buyers of de Havilland. Many of these contacts were followed by additional calls, discussions with management and reviews of de Havilland's facilities. Of the three bids ultimately received in October 1985, that of The Boeing Company was superior. It provided greater benefits to Canada both with respect to purchase price and in its potential to make de Havilland a healthy corporate entity over the long term. As the world's largest builder of passenger aircraft, Boeing is a natural associate for de Havilland. The current range of Boeing products does not include aircraft of the turboprop type and size produced by de Havilland, and the larger company's financial resources, combined with its technical and marketing expertise, should assist de Havilland in the marketing of its current Dash 8 as well as in the development of succeeding aircraft. Boeing has an excellent reputation in both the United States and Canada as a good corporate citizen and a well-managed enterprise.

The de Havilland Company lost $94 million in 1985, exceeding 1984's loss, primarily because of continuing development and early production costs associated with the Dash 8. While the Dash 8 has proved its potential to dominate worldwide markets in its size range, continuing high production development costs make it unlikely that any aircraft will be sold at a profit until at least 1987. Had the Company not been sold, the government would have been faced with the necessity of making further substantial capital injections. During 1985, $200 million was contributed to de Havilland. CDIC's accounts include de Havilland's operations for 1985, but also give effect to the sale at year-end.

Under the terms of sale, CDIC received $90 million in cash, notes payable over a period of years having a face value of $65 million and possible future royalties on sales of the de Havilland Dash 7 and Dash 8 if these sales exceed certain numbers.

The sale agreement provides that CDIC, on behalf of the Canadian government, has ongoing obligations relating to certain contingent liabilities. Net proceeds of the sale, as reflected in the accounts of CDIC, have been reduced by the amount of those obligations which have been quantified. In addition, the $65 million of notes receivable from The Boeing Company have been discounted to a present value of $24 million in accounting for net proceeds. These two factors have reduced the accounting value of the sale from $155 million to $80 million.

Due to the contingent nature of some obligations and the possible gains from future royalties, the final proceeds on the sale of de Havilland will not be known for some years. CDIC intends to dividend to the government the $65 million of notes receivable from The Boeing Company so that the future benefit of these notes will be received directly by the government.

Teleglobe Canada

While Teleglobe is not owned by CDIC and hence is not consolidated in the corporation's financial statements, CDIC has assumed responsibility for the management and divestiture of this Company.

A preliminary round of bids for Teleglobe was called for in the summer of 1985, and a large number of responses were received in

October. Certain policy considerations affect the sale of this Company, and the bids received provided useful information regarding these issues. The sale of Teleglobe requires legislation which, it is hoped, will be introduced shortly after the policy framework has been established.

Teleglobe's operations produced record results in 1985 and a $108 million dividend was paid by Teleglobe to the Government of Canada during the year. A further dividend of $80 million was paid early in 1986.

Canadair Limited

Discussions have been held with potential bidders for Canadair and considerable interest has been shown by a number of these parties. However, no acceptable bid has been received to date. Continued discussions with potential bidders may yield results in the near future.

Canadair Limited recorded record profits for the year aggregating $27.6 million, buoyed by sales of Challenger aircraft.

Eldorado Nuclear Limited

Due to depressed uranium prices and a heavy debt load, Eldorado Nuclear recorded a loss of $57 million for the year. While some prospects exist for improving prices, the Company does not anticipate earning a profit in 1986. Consideration is now being given to restructuring Eldorado's debt.

As the operator of Canada's only uranium processing facilities, Eldorado is a unique company. This position, together with the weakness of markets for its product, make divestiture particularly difficult, but discussions with several interested parties are continuing.

Canada Development Corporation

During 1985 CDIC initiated the sale, on an installment basis, of 23 million shares of CDC owned by the Government of Canada. Net proceeds of the sale to the government will total $253.9 million in 1985 and 1986. This sale was underwritten by a consortium of investment dealers lead by Burns Fry Limited. Passage of enabling legislation late in 1985 allows the sale to be completed in September 1986. The government continues to hold an 11.8% interest in CDC and until that interest is sold, the government will still be entitled to representation on CDC's Board. The government presently has five representatives on the CDC Board.

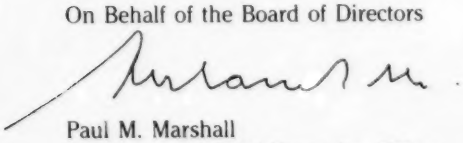
Massey-Ferguson Limited

Late in 1985, a letter of intent was signed agreeing in principle to a reorganization of Massey-Ferguson, which continues to be in financial difficulties. Under the terms of the proposed refinancing, in exchange for the Series D Preferred Shares of Massey-Ferguson now held, CDIC will receive securities in Massey Combines Corporation, a new company spun off from the parent Massey-Ferguson, as well as some securities in the ongoing Massey-Ferguson Limited. Massey Combines Corporation essentially consists of the Company's Brantford, Ontario factory plus the North American combines distribution network. The drastic decline in demand for combines in North America, which has led to the Company's substantial losses, is expected to continue for some time to come. The ongoing viability of the Company therefore remains questionable. However, to provide for the possibility of continuing operations at Brantford, the Government of Canada and the Government of Ontario plan to exchange a substantial part of their holdings in Massey-Ferguson for shares in Massey Combines.

Management Changes

The present incumbent assumed the office of President and Chief Executive Officer in October 1984 and has continued in this position to date. The original intention was that this would be a part-time, temporary involvement, but both its scope and duration have exceeded expectations. On November 1, 1985, it was announced that Pierre Des Marais II would join CDIC as Vice-Chairman of the Board and would succeed Mr. Marshall at a date to be mutually agreed between them. In the meantime, Mr. Des Marais has become Chairman, President and Chief Executive Officer of Canadair Limited following the resignation of Mr. Gilbert S. Bennett.

On Behalf of the Board of Directors



Paul M. Marshall
President and Chief Executive Officer
March 1986

CANADA DEVELOPMENT INVESTMENT CORPORATION

Minister Responsible for CDIC

The Honourable Sinclair McKnight Stevens, P.C., M.P.

Board of Directors

Bernard Lamarre, O.C. (1,2,4)*
President and Chief
Executive Officer
Lavalin Inc., Montreal

Pierre Des Marais II (1,2)**
Chairman, President and
Chief Executive Officer
Canadair Limited, Montreal

Richard A.N. Bonnycastle (2)
Chairman
Cavendish Investing Ltd.
Toronto

John Trevor Eyton, O.C. (2)
President and Chief
Executive Officer
Brascan Ltd., Toronto

John R. Grant (1)
Barrister
Cox, Downie and Goodfellow
Halifax

Patrick J. Keenan (2,3)
Chairman and Chief
Executive Officer
Keewhit Investments Ltd.
Toronto

Hélène LeBel, Q.C. (4)
Barrister
Rivest, Castiglio, Castiglio,
LeBel & Schmidt, Montreal

Paul M. Marshall (1,2)
President and Chief
Executive Officer
Canada Development Investment
Corporation, Toronto

John R. McCaig (3)
Chairman and Chief
Executive Officer
Trimac Limited, Calgary

Pierre Péladeau
President and Chief
Executive Officer
Quebecor Inc., Montreal

Paul J. Phoenix (3)
President and Chief
Executive Officer
Dofasco Inc., Hamilton

Donald McQ. Shaver,
C.M., D.Sc. (3)
Chairman
Shaver Holdings Ltd.
President
Deemcque Investments Ltd.
Cambridge

Frank Stronach (1)
Chairman and Chief
Executive Officer
Magna International Inc.
Markham

William R. Teschke (1,2,4)
Executive, Ottawa

Antoine Turmel, O.C. (2)
Executive, Montreal

Management

Paul M. Marshall
President and Chief
Executive Officer

Michael F.K. Carter
Executive Vice-President

G.S. Bennett
Vice-President

John R. Croll
Corporate Vice-President
and Secretary

Arthur F. Earle
Advisor to the President
Organization and Human
Resources

Committees of the Board

1. Executive Committee
2. Divestiture Committee
3. Audit Committee
4. Human Resources and
   Compensation Committee

*Chairman
**Vice-Chairman

Canadair earned net income of $27.6 million in 1985. In light of the fact that the highest level of annual net income previously achieved by the Company was $6.0 million in 1984, the Company's 1985 profit performance can be regarded as successful.

The 1985 improvement in net income is attributable to many factors, the more significant of which are the following:

(a) Increased confidence in the financial prospects for the Challenger 601 program has permitted Canadair to increase the rate of gross margin recorded in 1985 compared with prior years;

(b) in 1985, six Challenger CL-600 inventory aircraft were delivered to customers;

(c) Canadair recorded other income of $13.0 million in 1985, being interest income earned primarily from advance payments received from customers for future deliveries of aircraft.

As is evident from the foregoing significant factors, the Company's profitability is (and will continue to be) extremely sensitive to the rate at which Challenger aircraft are produced, sold and delivered. Throughout 1985, production of virtually all Canadair products, including Challengers, was carried on at relatively low levels. Material improvements in production levels and profits cannot be anticipated until the Company's markets strengthen and the ultimate ownership of Canadair is determined.

The year 1985 has seen further enhancement in market acceptance of Canadair's products. The Challenger again sold strongly in a weak market for business aircraft. Of particular significance was a sale of 12 aircraft to the Canadian government, complemented by 10 sales to commercial customers and a commitment from the Government of the People's Republic of China to purchase 3 Challenger CL-601s. The first deliveries of a new series of Waterbombers were made on schedule in late 1985. The Company's surveillance system programs were strengthened in 1985 by the commitment of significant government funding for development and preproduction activities. For the second consecutive year, Canadair's component manufacturing group was awarded the Boeing "Pride in Excellence" award (an award received only by the top 10% of Boeing's subcontractors).

Short-term prospects for the Company's Challenger and Waterbomber programs remain promising. The current backlog of firm orders for Challengers, if combined with a relatively small number of new orders to be obtained and filled in 1986, will result in the Challenger program making a major contribution to gross margin in 1986. Based on existing firm orders, the Waterbomber program will earn a substantial gross margin in 1986 and 1987.

To ensure continued market acceptance of the Challenger beyond 1986, Canadair announced in the fall of 1985 that the Company would introduce an improved Challenger early in 1987.

During 1985, the outlook continued to improve for the CL-289 and the CL-227, the Company's two new surveillance systems. Despite some schedule slippage, full funding for the preproduction phase of the CL-289 program was approved by the West German, Canadian and French governments. Actual preproduction activities have now begun and production is expected to start in mid-1987 for the purpose of meeting the stated requirements of several governments. Full-scale development of the CL-227 system was carried on throughout much of 1985, aided greatly by the Canadian government's commitment of a $30.9 million grant to Canadair under the Defence Industry Productivity Program.

The Company plans to continue its efforts to obtain new customers for the CL-289 system, given that a production program is now virtually assured. During 1986, contemporaneously with the development of the CL-227 system, Canadair will attempt to obtain agreements from various governments to test and evaluate the system when development is completed in 1987.

During 1985, Eldorado Nuclear Limited generated $220 million in revenues, a six per cent gain from the previous year. However, the Company also incurred increased financing costs and royalty payments. These factors, combined with continuing low prices for uranium, resulted in a net loss of $57.2 million for the year ended December 31, 1985.

The major influence on earnings was the depressed prices for uranium and conversion services. In 1985, spot prices were at their lowest levels since 1975, but they showed modest improvement during the second half. Most of Eldorado's revenue is derived from long-term sales contracts; however, most of the growth in revenue in recent years has come from spot sales. Depressed spot prices have therefore restrained revenue growth and eroded profitability industry-wide. 1985 was the first year since the advent of commercial nuclear power that nuclear reactors around the world consumed more uranium than the mining industry produced. However, the level of surplus inventory remains a concern.

Eldorado is among the most highly leveraged resource companies in Canada, carrying 2.9 times more debt than shareholder equity capital. The Company's five-year, $500 million capital expansion program has been financed without access to new cash equity. Net financing costs charged against income jumped from $52.3 million in 1984 to $73.1 million in 1985. This cost is equal to one-third of Eldorado's revenues. Another major influence on the 1985 results was the $24.4 million of mineral royalties paid to the Government of Saskatchewan, up 47 per cent from the previous year. Royalties consumed 11 per cent of the Company's total revenues and 38 per cent of operating profits.

During the year Eldor Mines began commissioning its $100 million Collins Bay "B" mine and renovated mill while continuing production, albeit at a reduced rate. Production increased at the Key Lake mine, in which Eldorado has a one-sixth interest, and the mill was operating at close to capacity in only its second full year of operation. The Fuel Services division processed a record volume of uranium and increased its share of total revenues from 25 per cent in 1984 to 32 per cent. In terms of both mining and processing, Eldorado was able to significantly reduce inventories last year.

Eldorado's exploration program substantially increased the Company's uranium resource base, ensuring sufficient reserves to feed the Rabbit Lake mill into the next century.

With the completion of the current capital expansion program, increasing effort will be directed to the development of additional uranium reserves near Rabbit Lake, particularly those being discovered at Eagle Point. These reserves consist of two properties – Eagle South, wholly-owned by Eldorado, and Eagle North, an Eldorado-operated joint venture. Geologic reserves identified to date at the two deposits exceed 50,000 tonnes U., four times those at Collins "B".

The Eagle Point ore features high grades and simple mineralogy in stable host rock, indicating that conventional mining methods are generally feasible. A single mining operation at Eagle Point may prove to be the most efficient and orderly development plan. The ore lends itself to processing in the new milling circuit at Rabbit Lake. The identification of substantial additional quantities of high-quality uranium reserves in 1985 has consolidated Eldorado's position as a world-scale Canadian supplier beyond the year 2000.

Teleglobe Canada's net operating revenues reached $240.5 million this year, 10 per cent higher than the $218.5 million recorded in the same period of 1984. As well, net income for the year rose to $53.2 million compared to $46.1 million in 1984, an increase of 15.4 per cent.

In light of these results, the Board of Directors therefore authorized payment of a $26.6 million regular remittance to the Government of Canada representing 50 per cent of the corporation's net income. In addition, a special payment of $53.4 million was authorized by the Board.

In 1985 the corporation continued to implement programs which are aimed at constantly improving services and optimizing the productivity of its operations.

Teleglobe Canada offers a complete range of international telecommunications services to meet the needs of business and the general public. Traditional services such as telephone and telex continue to play a fundamental role and to generate revenues which should increase at an average annual rate of 14% for telephone and 9% for telex. Teleglobe Canada also anticipates strong growth in the specialized service market due to the specific needs of a changing business environment. Progressive digitization of the international network's transmission and switching facilities will enable carriers to offer new service enhancements for the benefit of all users. By developing these services, Teleglobe Canada will be able to handle new market realities and ensure its viability as an international carrier.

No other telecommunications service is as universal as the telephone. During 1985, the Corporation recorded a volume of 328.7 million minutes of telephone traffic, an increase of 16.2% over the same period in 1984.

On September 1, Teleglobe Canada introduced lower rates for telephone calls on Saturdays and weekday evenings to eleven western European countries. This brings to fifteen the number of countries in that region which have reduced charges for direct dial calls. These new rates, which are being publicized in a TV ad campaign launched in September, are designed to stimulate traffic and reduce Sunday telephone congestion. Estimates indicate that the lower rates will save telephone subscribers $3 million in 1986. Canadian telephone users can now dial 90 countries direct, at costs of 10 to 35 per cent less than operator handled calls. At least 70 per cent of Canadian telephone users have access to direct dialing.

Telex is the most widely-used international message service. It is still the only message network offering instantaneous text communications to virtually every country in the world. In 1985, Teleglobe Canada recorded 37.6 million minutes of telex traffic or 8.7 per cent more than in the same period of the previous year.

This year business users were able to take advantage of the corporation's store and forward *Globetex* service which, for Canadian users of telex and high speed terminals, represents a cost-effective link.

Teleglobe Canada has just completed the digitization of its telephone and message switching systems, a process begun in 1982. The corporation is presently converting the international portion of its network, between the switching centres and their foreign counterparts, with a view to implementing an integrated services digital network to meet the requirements of the 21st century.

With the cooperation of British Telecom International, Teleglobe Canada became the first international carrier to set up private satellite business services (PSBS) in 1984. Aimed primarily at large corporate users and based on small-dish technology, these digital services have secured Teleglobe Canada a place in the market for new specialized services. PSBS is considered one of the most promising areas for future growth, although it still accounts for only a minor portion of international telecommunication traffic.

Optimization of productivity remains a priority at the operational and administrative level. In 1985, therefore, Teleglobe Canada continued with programs to rationalize its human and material resources. Through advances in office automation and computer technology, the corporation has been able to consolidate these resources along with its operational activities.

CDIC holds the Federal Government's interests in Massey-Ferguson. Since 1978, Massey-Ferguson has been faced with serious financial and operational problems reflecting depressed conditions in the farm machinery industry and its own financial structure. These problems resulted principally from a shrinking worldwide market for farm and industrial machinery and diesel engines, excess production capacity in the farm machinery industry, and the substantial amount of debt incurred by the Company (much of it on a short-term floating rate basis) in the 1970s in connection with a program of expansion through internal growth and acquisitions. As a result of reduced revenues and high interest rates, after 1978 the Company incurred substantial operating losses and during certain periods its cash flow has been insufficient to meet its cash obligations.

As a result of its financial difficulties, the Company was required to renegotiate its non-public credit facilities and loan agreements with its lenders in the 1981 financial restructuring and again in the 1983 financial restructuring. The Company also secured the financial assistance of the Governments of Canada, Ontario, France and, through ECGD, the United Kingdom.

These financial and operations restructurings have enabled the Company to make significant progress toward achieving its goal of long-term financial viability. Despite these efforts, which have lowered the Company's operational break-even point dramatically, depressed agricultural commodity prices, the continued decline in the demand for farm machinery (particularly for combine harvesters) and several years of large operating losses and rationalization costs have left the Company with an excessive level of debt and other fixed charge obligations.

Massey-Ferguson's proposed restructuring involves the recapitalization of Massey-Ferguson Limited, reducing the debt level, eliminating arrears of preferred dividends and simplifying capital structure. The Combines division will be split off and the balance of Massey-Ferguson Limited will be continued on a basis that should provide for the probability of profits in future years. CDIC is taking securities in Massey-Ferguson Limited but is transferring a large portion of its investment to shares in Massey Combines Corporation (MCC) a new company that will take over the combines business from Massey-Ferguson Limited. This is being done to allow this business, which has experienced severe losses, to continue.

The North American combines industry continues to suffer from a prolonged contraction in demand and chronic excess production capacity. Industry sales of combine harvesters in North America have declined from 41,000 units in the year ended January 31, 1979 to an estimated 10,000 units in the year ended January 31, 1986.

Although general industry conditions are currently bleak, MCC has a sound product line and dealer network. Its share of the North American combines market has ranged between 13.6% and 18.4% over the past five years, with a market share of approximately 14.6% during the year ended January 31, 1985 and approximately 13.6% during the nine months ended October 31, 1985. MCC's market position will be enhanced as a result of its recent acquisition of rotary combines technology which is being utilized to develop a product line of high horsepower combines, a range in which the Company's products have until now been limited.

Accordingly, it is believed that MCC can be viable over the long term if appropriate rationalization and restructuring actions are taken to further reduce its operational breakeven point and if market conditions improve moderately over the next few years. However, it remains a company with a heavy debt load in an industry with a huge overcapacity. Large losses are anticipated in the initial periods.

It is anticipated that the cash required by MCC to fund both the costs associated with rationalization as well as the ongoing operating losses during this rationalization period will be provided by internally generated funds including those resulting from the concessions granted by lenders. The MCC Notes will contain concessionary terms which will provide MCC with substantial relief from debt servicing requirements.

CDIC has agreed to support MCC by, in effect, exchanging a significant portion of its investment in the Series D Preferred Shares of Massey-Ferguson Limited for MCC Preferred Shares. CDIC will also receive 20% of the MCC Common Shares.

While it is hoped that the Restructuring Plan provides MCC with sufficient financial resources and operational flexibility to implement the necessary rationalization actions, MCC will continue to face the risks that have been associated with the farm machinery business in general and with the combine harvester business in particular.

CANADA DEVELOPMENT INVESTMENT CORPORATION

The Honourable Sinclair McKnight Stevens, P.C., M.P.
Minister responsible for
Canada Development Investment
Corporation

We have examined the consolidated balance sheet of Canada Development Investment Corporation as at December 31, 1985 and the consolidated statements of income (loss) and accumulated deficit, contributed surplus and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the corporation as at December 31, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Further, in our opinion, the transactions of the corporation and of its wholly-owned subsidiaries that have come to our notice during our examination of the consolidated financial statements have, in all significant respects, been in accordance with Part XII of the Financial Administration Act and regulations, and the charters and by-laws of the corporation and its wholly-owned subsidiaries.

Kenneth M. Dye, F.C.A.
Auditor General of Canada
Ottawa, Canada

Peat, Marwick, Mitchell & Co.
Chartered Accountants
Toronto, Canada
March 21, 1986

Consolidated Balance Sheet
December 31, 1985

CANADA DEVELOPMENT INVESTMENT CORPORATION

(All dollar amounts are stated in thousands)	1985	1984
Assets		
Current assets:		
Cash and short-term investments	$ **3,588**	$ 9,863
Due from related parties	**160**	710
Other receivables	**2,815**	—
	6,563	10,573
Investments	**635,355**	606,067
Unamortized foreign exchange losses	**—**	61,514
Other	**151**	411
	$ **642,069**	$ 678,565
Liabilities and shareholder's equity (deficiency)		
Current liabilities:		
Accounts payable and accrued liabilities	$ **3,529**	$ 14,177
Payable to related parties	**—**	74,551
Accrued interest	**8,164**	37,957
Current portion of long-term debt	**143,864**	13,217
	156,557	139,902
Long-term debt of Canadair Financial	**—**	1,247,540
Shareholder's equity (deficiency):		
Capital stock:		
Authorized — unlimited number of common shares		
Issued and fully paid — 101 common shares	**1**	1
Contributed surplus	**3,351,848**	1,772,007
Accumulated deficit	**(2,866,337)**	(2,480,885)
	485,512	(708,877)
Subsequent events (note 11)		
Commitments and contingencies (notes 4, 10 and 11)		
	$ **642,069**	$ 678,565

On behalf of the Board:

Director

Director

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statement of Income (Loss) and Accumulated Deficit
For the year ended December 31, 1985

CANADA DEVELOPMENT INVESTMENT CORPORATION

(All dollar amounts are stated in thousands)	Canadair	de Havilland	Eldorado	CDIC	Total 1985	Total 1984
Operating income (loss)	$ 30,453	$ 19,312	$ 44,702	$ (3,531)	$ 90,936	$ 83,508
Financial (expense) income	(1,375)	810	(73,126)	(211,209)	(284,900)	(249,604)
Unusual expense items	—	(114,724)	(4,350)	—	(119,074)	(44,492)
Royalty and tax (expense) recovery	(9,479)	176	(24,430)	—	(33,733)	(18,322)
Provision for reduction in value of investments	—	—	—	(46,656)	(46,656)	—
	19,599	(94,426)	(57,204)	(261,396)	(393,427)	(228,910)
Extraordinary items	7,975	—	—	—	7,975	12,448
Net income (loss) for the year ended December 31, 1985	$ 27,574	$ (94,426)	$ (57,204)	$ (261,396)	(385,452)	
Net income (loss) for the year ended December 31, 1984	$ 6,044	$ (40,377)	$ 4,427	$ (186,556)	—	(216,462)
Accumulated deficit, beginning of year					(2,480,885)	(2,264,423)
Accumulated deficit, end of year					$ (2,866,337)	$ (2,480,885)

Consolidated statement of contributed surplus
For the year ended December 31, 1985

(All dollar amounts are stated in thousands)	**1985**	1984
Balance, beginning of year	**$1,772,007**	$1,222,007
Assumption of long-term debt of Canadair Financial by the Government of Canada	**1,079,841**	—
Contributed in cash by the Government of Canada to subsidiaries:		
Canadair Financial	**300,000**	310,000
de Havilland	**200,000**	240,000
Balance, end of year	**$3,351,848**	$1,772,007

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statement of Changes in Financial Position
For the year ended December 31, 1985

CANADA DEVELOPMENT INVESTMENT CORPORATION

(All dollar amounts are stated in thousands)	**1985**	1984
Source of funds:		
Contributed surplus (Canadair Financial)	**$1,379,841**	$ 310,000
Uses of funds:		
Corporate operations	**3,531**	650
Item not affecting cash — depreciation	**(49)**	(130)
Interest and financing expenses net of amortization of foreign exchange losses	**94,814**	152,050
Decrease (increase) in long-term debt	**1,116,893**	(40,212)
Decrease in payable to related parties	**74,551**	81,156
Decrease in bank indebtedness	**—**	23,507
Deemed contribution to Canadair Limited	**—**	98,453
Decrease (increase) in accounts payable	**10,648**	(5,148)
Increase (decrease) in other items, net	**85,728**	(1,754)
	1,386,116	308,572
Increase (decrease) in cash and short-term investments	**(6,275)**	1,428
Cash and short-term investments, beginning of year	**9,863**	8,435
Cash and short-term investments, end of year	**$ 3,588**	$ 9,863

The accompanying notes are an integral part of these consolidated financial statements.

(All dollar amounts are stated in thousands)

1. The corporation

Canada Development Investment Corporation ("the corporation") was incorporated on May 26, 1982 under the provisions of the Canada Business Corporations Act and is wholly-owned by Her Majesty in right of Canada. The corporation is subject to the Financial Administration Act and the Government Companies Operation Act and is an agent of Her Majesty.

2. Basis of presentation

In a statement dated October 30, 1984, the Minister of the Government of Canada responsible for the corporation announced the intention of the Government to cause the corporation to dispose of its investments in Massey-Ferguson Limited ("Massey-Ferguson"), Canadair Limited ("Canadair"), The de Havilland Aircraft of Canada, Limited ("de Havilland") and Eldorado Nuclear Limited ("Eldorado") in an orderly fashion. The Board of Directors of the corporation is developing an approach to the divestiture of these investments which would meet the requirements of the Government; however, no formal plan to dispose of the investments has been approved by the Government except for the disposal of the corporation's investment in de Havilland (see note 11). Any divestiture plan or proposal will require formal approval by the Government pursuant to the requirements of the Financial Administration Act.

As no formal plans of divestiture have been presented for approval with respect to Canadair and Eldorado, the corporation believes that it is appropriate to continue to carry the investments in Canadair and Eldorado on the equity basis of accounting. Eventual disposal prices for these subsidiaries may be more or less than these carrying values.

3. Significant accounting policies

(a) Basis of consolidation:
The financial statements of Canadair Financial Corporation Inc. ("Canadair Financial") have been consolidated with those of the corporation.

(b) Investments in non-consolidated subsidiaries:
Investments in subsidiaries originally acquired with the objective of their eventual disposition or privatization are accounted for on the equity basis, unless there is a formal plan, approved by the Government of Canada, to dispose of the investment, in which case the investment is carried at the lower of the equity basis carrying value and net realizable value. A consolidation of the corporation's financial statements and these subsidiaries has not been prepared as the corporation believes that the equity method provides a more informative presentation to the shareholder. The consolidated financial statements of each non-consolidated subsidiary are attached.

(c) Portfolio investment:
The corporation's portfolio investment is accounted for on the cost basis, unless there has been a measurable impairment in value which is other than temporary, in which case the investment is written down to recognize the loss.

(d) Foreign currency translation:
Foreign currency assets and liabilities are translated into Canadian dollars in accordance with the temporal method. Under that method, monetary assets and liabilities are translated at the year-end rate, non-monetary assets and liabilities are translated at rates in effect on the dates of the transactions.

4. Investments

The carrying value of the corporation's investments is as follows:

	Carrying Value December 31, 1984	Contributions from the Government of Canada	Equity in Income (Loss)	Provision for Reduction in Value	Carrying Value December 31, 1985
Non-Consolidated Subsidiaries:					
Canadair	$196,428	$ —	$ 27,574	$ —	$224,002
de Havilland	21,082	200,000	(94,426)	(46,656)	80,000
Eldorado	262,208	—	(57,204)	—	205,004
	479,718	$200,000	$(124,056)	$(46,656)	509,006
Portfolio Investment: Series D Preferred Shares of Massey-Ferguson	126,349				126,349
	$606,067				$635,355

(a) As discussed in note 11, the corporation disposed of its investment in de Havilland on January 31, 1986. Accordingly, the carrying value of the corporation's investment in de Havilland has been written down to its estimated net realizable value.

(b) The corporation believes that there is a possibility that the cost of its investment in Massey-Ferguson, as reflected in these financial statements, significantly exceeds the value of that investment; however, the specific value of this portfolio investment is not reasonably estimable at this time.

Massey-Ferguson has announced an intention to reorganize itself and the corporation has signed a letter of intent to agree to this reorganization. At this time, Massey-Ferguson has not completed negotiations with the various parties concerned and major issues are still to be settled.

(c) As at December 31, 1985 the Government of Canada provides authorities and guarantees for the borrowings of Canadair, de Havilland and Eldorado as follows:

	Maximum Authorities	Maximum Guarantees	Utilization as at December 31, 1985
Canadair	$ —	$ —	$ —
de Havilland	—	450,000	7,669
Eldorado	600,000	—	561,775

5. Long-term debt of Canadair Financial

	1985	1984
Term loan due August 22, 1985 with interest at 9 3/4% (U.S. $10 million)	$ —	$ 13,217
Term bank loan due May 7, 1986 with interest at LIBOR plus 1/2% (U.S. $187.5 million)	—	247,819
Term bank loan due December 1, 1986 with interest at LIBOR plus 3/8% (U.S. $75 million)	—	99,128
Term notes due March 15, 1987 with interest at 15 1/2%, callable after March 15, 1985 at 101% of principal amount; 100 1/2% after March 15, 1986 (U.S. $150 million)	—	198,255
Notes due June 1, 1987 with interest at 16 3/8% (U.S. $50 million)	**69,915**	66,085
Term bank loan due November 11, 1988 with interest at LIBOR plus 3/8% or U.S. prime rate revolving to November 11, 1986 with payments equal to 25% of the outstanding balance commencing from May 11, 1987 and continuing semi-annually until maturity (U.S. $85 million)	—	112,345
Syndicated term loan due March 6, 1989 with interest at LIBOR plus 3/8% or U.S. prime rate to March 12, 1985 and LIBOR plus 1/2% or U.S. prime rate plus 1/8% thereafter, revolving to March 6, 1987, with payments equal to 25% of the outstanding balance commencing from September 6, 1987 and continuing semi-annually until maturity (U.S. $75 million)	—	99,128
Notes due November 15, 1989 with interest at 12 1/2% callable at a maximum of 105% of principal amount (U.S. $175 million)	—	231,298
Term loans due March 22, 1992 with interest at prime rate less 3/4%, revolving until March 22, 1987, with payments equal to 5% of the outstanding balance commencing from March 22, 1988 and continuing semi-annually with the balance repayable at maturity	**32,000**	63,216
Sub-total, carried forward	**$ 101,915**	$1,130,491

	1985	1984
Sub-total, brought forward	**$ 101,915**	$1,130,491
Term loan due March 22, 1992 with interest at prime rate less 3/4%, with payments equal to $5 million commencing from March 22, 1988 and continuing semi-annually with the balance repayable at maturity	**—**	100,000
Discounted note due April 26, 1992 with interest at 8 1/2% with annual installments of U.S. $6 million commencing April 26, 1988 (U.S. $30 million)	**41,949**	39,650
Less unamortized discount on issuance of long-term debt	**—**	(9,384)
Sub-total	**143,864**	1,260,757
Less principal included in current liabilities	**(143,864)**	(13,217)
	$ —	$1,247,540

The Government of Canada has the authority to guarantee certain financial arrangements of Canadair Financial with financial institutions to a maximum $1,350,000. In March 1985, the Government of Canada contributed $300,000 (1984 — $310,000) to the equity account of Canadair Financial.

In June 1985, the Government of Canada indicated its intention to assume the long-term debt of Canadair Financial. Accordingly, between June 25, 1985 and December 31, 1985, with the concurrence of the relative lenders (where practicable), the Government of Canada assumed certain of the debt amounting to $1,079,841. The assumption of this debt, which includes accrued unpaid interest of $35,578 thereon, has been accounted for as contributed surplus. The balance of the debt at December 31, 1985 of $143,864 is reflected as a current liability (see note 11).

In addition, all deferred charges associated with the long-term debt, consisting mainly of unamortized foreign exchange variances, have been expensed during the year.

6. Interest and other financing expenses — Canadair Financial

	1985	1984
Interest on long-term debt (including amortization of discount)	**$ 102,949**	$ 146,641
Interest on other debt	**2,375**	2,713
Foreign exchange	**105,885**	36,552
	$ 211,209	$ 185,906

7. Operating income (loss) — CDIC

	1985	1984
Service fees from subsidiaries	**$ 3,084**	$ 5,862
Interest earned on short-term investments	**418**	694
	3,502	6,556
Corporate expenses	**7,033**	7,206
	$ (3,531)	$ (650)

8. Directors' and officers' remuneration

	Directors' Fees	Salaries and Benefits	Other	Total
Remuneration of directors:				
Number of Directors — 15				
Incurred by the corporation	$147			$ 147
Remuneration of Officers[a]:				
Incurred by the corporation		$832	$113	945
	$147	$832	$113	$1,092

(a) There were six persons who served as officers during the year. There were five officers at year end.

9. Income tax

As at December 31, 1985 Canadair Financial has tax losses of $412,000 available to reduce taxable income expiring as follows:

1987	$ 64,000
1990	256,000
1991	92,000
	$412,000

The potential future tax reductions relating to these losses carried forward have not been recorded in these financial statements. They will be recorded, when realized, as an extraordinary item.

10. Lease commitments

Lease commitments under operating leases for office premises with terms of more than one year total $556. The aggregate annual minimum lease payments under these arrangements is as follows:

1986	$424
1987	132
	$556

11. Subsequent events

(a) Disposal of de Havilland:

On January 31, 1986 the corporation sold its investment in de Havilland to The Boeing Company ("Boeing"). The consideration for the sale was $155,000 of which $90,000 was received in cash on closing. $65,000 of the purchase price is payable in installments, without interest, over a fifteen year period. These installments shall be reduced by an amount equal to 20% of the Canadian content of any incremental work packages placed by Boeing at de Havilland's Downsview facilities or any other Boeing facility in Canada.

The corporation and the Government of Canada have agreed to indemnify Boeing and de Havilland for certain contingent liabilities and other expenditures which may be incurred by Boeing and de Havilland over a maximum of six years after closing.

These contingent liabilities include the following:

(i) A portion of de Havilland's product liability insurance premiums;

(ii) Certain suppliers' claims which may be asserted against de Havilland for production slow-down or termination, and potential claims against de Havilland pursuant to product financing agreements up to a maximum of $60,000.

As indicated in note 4, the net realizable value of the corporation's investment in de Havilland is presently estimated to be $80,000.

This estimate is based upon the following considerations:

- The discounting of the $65,000 portion of the purchase consideration represented by non-interest bearing installments due over fifteen years.
- An estimate of the amounts which the corporation believes are likely to be paid to Boeing and/or de Havilland pursuant to the indemnities contained in the agreement of purchase and sale. These estimates have been made by the corporation based on information currently available and involve the forecasting of certain future events and conditions. These forecasts are likely to be different than actual events and conditions; accordingly, refinements of these estimates may be necessary in future fiscal periods. In addition, reasonable estimates of the effects of certain of these future events and conditions cannot be made at this time; therefore, no provision for the related indemnity liability has been reflected in this estimate of net realizable value. Such amounts will be recognized as appropriate in future fiscal periods when reasonable estimates can be made as to the likely amount, if any, which will ultimately be paid pursuant to the indemnities.

(b) Long-term debt of Canadair Financial: The Government of Canada assumed the balance of the outstanding debt of Canadair Financial of $143,864, plus accrued interest, during February 1986.

Auditors' Report

CANADAIR LIMITED

To the Shareholders of Canadair Limited:

We have examined the consolidated balance sheet of Canadair Limited as at December 31, 1985 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances. The financial statements of the preceding year were examined by other chartered accountants.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

We further report that, in our opinion, the transactions that have come to our notice in the course of our examination of these consolidated financial statements have been in all significant respects in accordance with Part XII of the Financial Administration Act and regulations and the charter and by-laws of the Corporation.

Ernst & Whinney
Montreal, Canada

March 21, 1986

Consolidated Balance Sheet
As at December 31, 1985

CANADAIR LIMITED

(Incorporated under the laws of Canada)

(All dollar amounts are stated in thousands)	**1985**	1984
Assets		
Current assets		
Cash and certificates of deposit	**$ 74,287**	$ 5,331
Term deposits (note 3)	**117,983**	38,921
Accounts receivable	**45,251**	34,736
Receivable from affiliate	**—**	74,405
Contracts and programs in process and inventories less advances and progress billings (note 4)	**186,749**	257,776
Prepaid expenses	**1,919**	1,381
	426,189	412,550
Property, plant and equipment (note 5)	**126,735**	123,288
Less accumulated depreciation	**74,773**	68,573
	51,962	54,715
	$ 478,151	$ 467,265

Approved on behalf of the Board

Director

Director

Consolidated Balance Sheet
As at December 31, 1985

CANADAIR LIMITED

(Incorporated under the laws of Canada)

(All dollar amounts are stated in thousands)	1985	1984
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	**$ 70,062**	$ 87,641
Customer advances, contract and program related accruals	**169,179**	166,981
Current portion of long term debt	**1,777**	1,789
	241,018	256,411
Long term debt (note 6)	**13,131**	14,426
Shareholders' equity		
Capital stock (note 7)	**179,031**	179,031
Retained earnings	**44,971**	17,397
	224,002	196,428
	$ 478,151	$ 467,265

Contingencies (note 12)

Consolidated Statement of Income
Year ended December 31, 1985

CANADAIR LIMITED

(All dollar amounts are stated in thousands)	**1985**	1984
Sales	**$ 438,010**	$ 376,443
Other income	**13,065**	—
	451,075	376,443
Cost and expenses		
Cost of sales	**346,486**	309,009
Research and development	**20,425**	10,821
Selling, general and administrative	**53,711**	48,990
Interest on long term debt	**1,375**	1,504
	421,997	370,324
Income before income taxes and extraordinary item	**29,078**	6,119
Income taxes	**9,479**	1,523
Income before extraordinary item	**19,599**	4,596
Extraordinary item		
Reduction of income taxes arising from the utilization of prior years' unclaimed tax deductions	**7,975**	1,448
Net Income	**$ 27,574**	$ 6,044

Consolidated Statement of Retained Earnings
Year ended December 31, 1985

CANADAIR LIMITED

(All dollar amounts are stated in thousands)	**1985**	1984
Retained earnings (deficit) at beginning of year	**$ 17,397**	$ (87,100)
Deemed contributed surplus	**—**	98,453
Income for the period	**27,574**	6,044
Retained earnings at end of year	**$ 44,971**	$ 17,397

Consolidated Statement of Changes in Financial Position

Year ended December 31, 1985

CANADAIR LIMITED

(All dollar amounts are stated in thousands)	1985	1984
Operating activities		
From operations:		
Income before extraordinary item	**$ 19,599**	$ 4,596
Non-cash item		
Depreciation	**6,410**	5,374
Total from operations before extraordinary item	**26,009**	9,970
Extraordinary item	**7,975**	1,448
Total from operations	**33,984**	11,418
Decrease in accounts receivable from affiliate	**74,405**	80,595
Decrease (increase) in inventories, contracts and programs in process — net	**71,027**	(1,777)
Total sources from operating activities	**179,416**	90,236
Increase in term deposits	**79,062**	38,921
Increase (decrease) in accounts receivable and prepaid expenses	**11,053**	(1,489)
Decrease in current liabilities	**15,381**	144,848
Total use from operating activities	**105,496**	182,280
Net from operating activities	**73,920**	(92,044)
Financing activities		
Decrease in long term debt	**(1,307)**	(1,025)
Deemed contributed surplus from affiliate	**—**	98,453
Issue of shares	**—**	155,001
Loan to affiliate	**—**	(155,000)
Net of financing activities	**(1,307)**	97,429
Investing activities		
Additions to equipment, net	**(3,657)**	(5,169)
Increase in cash and certificates of deposit	**68,956**	216
Cash at beginning of year	**5,331**	5,115
Cash and certificates of deposit at end of year	**$ 74,287**	$ 5,331

1. Summary of significant accounting policies

Basis of presentation and consolidation

The consolidated balance sheet and consolidated statements of income and retained earnings and changes in financial position include the assets and liabilities, results of operations and changes in financial position of the Company's wholly-owned subsidiaries, Canadair Services Limited, Canadair Challenger Inc. and Challenger Aviation Service GmbH. Certain 1984 numbers have been reclassified to conform with the presentation adopted for 1985.

Accounting for long term contracts and programs

In accordance with industry practice, work in process under long term government contracts and commercial contracts and programs is classified as a current asset on the balance sheet even though a portion is not expected to be realized within one year.

Government contracts are accounted for primarily using the percentage-of-completion method whereby sales are recorded as costs are incurred or as units are delivered and include that proportion of estimated earnings at contract completion that costs incurred to date bear to estimated costs at contract completion. Work in process includes direct costs incurred, factory overhead, general and administrative expenses, plus estimated earnings on such costs, less advances and progress billings. Earnings are included in income only when sufficient production has been accomplished to permit estimation of total contract earnings with a minimum of risk. At such time, earnings are recorded based on the work completed to date. Estimated losses are charged to income as soon as they are identified.

Commercial contracts and programs are accounted for primarily under the program method of accounting and are stated at actual production costs incurred, including factory overhead, and, except for the Challenger program (note 2), development, tooling and general and administrative expenses, less advances and progress billings. Sales and earnings are recognized as units are delivered. The cost of delivered units is calculated at the actual selling price less the gross margin, which is estimated for the program using a conservative program quantity for accounting purposes. Program assessments are performed periodically to determine the estimated gross margin percentage. Should a negative gross margin be forecast, the work in process is written down in the period to estimated net realizable value.

Estimated earnings or losses on government contracts and commercial contracts and programs are determined from projected revenues and manufacturing costs taking into account factors such as expected sales, price levels, production costs and other variables which may be beyond the Company's control. Because these factors cannot be measured with precision, the estimates are subject to periodic revisions. Contract earnings and losses recorded in the current year include the cumulative effect of revisions to prior years' estimates. Changes to estimated program earnings are accounted for prospectively.

Title to work performed under certain contracts in process and to related inventories is vested in the customer in accordance with contract provisions.

Inventories

Inventories of commercial products, materials and spare parts are stated at the lower of average cost or estimated net realizable value.

Research and development costs

Research and development costs recoverable pursuant to contracts are included in work in process. Product development costs directly related to company-sponsored production programs and all company funded research and development programs are currently charged to income.

Foreign currency translation

Foreign currency assets and liabilities, including those of foreign subsidiaries Canadair Challenger Inc. and Challenger Aviation Service GmbH, are translated into Canadian dollars in accordance with the temporal method. Under that method, monetary assets and liabilities are translated at the year-end rate and non-monetary assets, liabilities, revenue and expenses are translated at the effective rate at the time of the transaction.

Property, plant and equipment

Buildings, machinery and equipment are stated at cost. Land is stated at the 1974 appraised value net of disposals.

Depreciation is provided principally on a declining balance basis. The depreciation rates for buildings vary from 4% to 10% and the rates for machinery and equipment vary from 20% to 30%. The depreciation of certain machinery is based on usage over the estimated life of the machinery. Leased equipment is depreciated principally on a straight-line basis over three years.

Pension costs

Current service costs under Company pension plans are charged to costs incurred as they accrue and are funded as necessary following the most recent actuarial review of the plans. Past service costs are charged to costs incurred over varying periods as they are funded.

2. Challenger program

The Company currently follows the program method of accounting for the Challenger 601 program based on the program accounting quantity of 66 aircraft, the number to be produced before the introduction of the Challenger 601-3A model early in 1987. Pursuant to a program assessment made as of December 1982, all Challenger non-recurring program costs were written off and, accordingly, the current inventoried costs do not include any amounts of development, tooling and excess early learning or other deferred costs. No gross margin was recorded prior to March 30, 1984, at which time the Company underwent a financial restructuring. Subsequent to that date, gross margin has been recorded based on conservative estimates of program revenues and costs. Changes to such estimates affecting program gross margin recorded in a prior period are accounted for prospectively.

All Challenger 601 product improvement, product support, marketing and general and administrative costs are expensed as incurred. Aircraft in finished goods inventory are valued at the lower of estimated cost or net realizable value. Commitments to suppliers for production material for the Challenger 601 and the Challenger 601-3A aggregated $240 million at December 31, 1985.

At December 31, 1985, 44 Challenger 601 aircraft had been delivered and the Company had firm orders for 11 aircraft.

3. Term deposits

Term Deposits comprise advance payments from customers and include $86.7 million of advance payments received from a customer, and assigned by the Company to a financial institution as security for an advance payment guarantee provided to the customer by the financial institution as required under the contract. The deposits with interest will be released to the company as outfitted aircraft are delivered to the customer commencing in early 1986.

4. Contracts and programs in process and inventories

Contracts and programs in process and inventories at December 31 consisted of:

(All dollar amounts are stated in thousands)	**1985**	1984
Challenger program:		
Finished goods	**$ 11,662**	$ 62,344
Work in process, materials, supplies and spares less advances of $72.2 million (1984 — $9.6 million)	**139,686**	153,427
	151,348	215,771
Other programs, contracts and products:		
Finished goods	**3,288**	9,792
Work in process, materials, supplies and spares less advances and progress billings of $81.7 million (1984 — $42.8 million)	**32,113**	32,213
	35,401	42,005
	$ 186,749	$ 257,776

5. Property, plant & equipment

Property, plant and equipment at December 31 consisted of:

(All dollar amounts are stated in thousands)	**1985**			1984
	Assets	Accumulated Depreciation	Net book value	Net book value
Buildings	$ 45,429	$ 21,990	$ 23,439	$ 24,376
Machinery and Equipment:				
Owned	61,922	46,683	15,239	15,764
Capital leases	7,374	6,100	1,274	2,507
	114,725	74,773	39,952	42,647
Land, at 1974 appraised value, net of disposals	12,010	—	12,010	12,068
	$ 126,735	$ 74,773	$ 51,962	$ 54,715

6. Long Term Debt

Long term debt at December 31 consisted of:

(All dollar amounts are stated in thousands)	**1985**	1984
Mortgage loan due January 1, 1994, with interest at 7 1/8% to January 1, 1989 and 7 1/4% thereafter (U.S. $6 million)	**$ 8,390**	$ 7,930
Defence Industry Productivity Program funding	**1,115**	1,733
Obligations under capital leases expiring through 1989 with interest varying from 9 1/2% to 14 1/2%	**5,403**	6,552
Total long term debt	**14,908**	16,215
Less principal included in current liabilities	**(1,777)**	(1,789)
	$ 13,131	$ 14,426

Estimated repayments in future years are as follows:

(All dollar amounts are stated in thousands)	Capital leases	Other long term debt
1986	**$ 2,383**	$ 278
1987	**2,050**	1,117
1988	**1,787**	1,117
1989	**328**	1,330
1990	**–**	1,258
Subsequent years	**–**	4,405
	6,548	9,505
Interest on capital leases	**(1,145)**	–
	$ 5,403	$ 9,505

7. Capital stock

The authorized capital stock of the Company consists of an unlimited number of common shares and an unlimited number of non-voting, redeemable, preferred shares with a non-cumulative dividend entitlement of 8% of their paid-up value.

The Company's capital stock consists of 10 million common shares issued for $1 thousand, 155,000 preferred shares issued for $155 million and 24,030 preferred shares issued in consideration for the net assets transferred to the Company on March 30, 1984, the date of the Company's financial restructuring.

8. Sales by class of business

Substantially all of the Company's operations are in the aerospace industry. Sales were distributed as follows:

(All dollar amounts are stated in thousands)	**1985**	1984
Aircraft	**$ 417,526**	$ 354,768
Surveillance systems	**20,058**	17,375
Other	**426**	4,300
	$ 438,010	$ 376,443

The Company had export sales in 1985 of $241.0 million (1984 — $313.5 million).

9. Related party transactions

The Company is a wholly-owned subsidiary of Canada Development Investment Corporation, a Crown Corporation.

Sales to the Government amounted to $164.8 million in 1985 (1984 — $47.6 million). Amounts due from and owing to the Government at December 31, 1985, were $3.7 million and $2.1 million, respectively (1984 — $4.4 million and $2.9 million, respectively). Related party sales during the year were made on the same terms and conditions as similar sales to unrelated parties. Progress payments against the CL-215 aircraft ordered by the Government of Canada in 1983 amounted to $37.1 million in 1985.

A management fee of $1.7 million was paid to Canada Development Investment Corporation in 1985 (1984 — $3.2 million).

10. Income taxes

As at December 31, 1985, the tax values of depreciable assets exceeded corresponding net book values by approximately $90 million. The Company has unclaimed expenses of $12 million deductible in determining the taxable income of future years. The potential future tax benefits from these items have not been recognized in the financial statements. In addition, the Company has unutilized investment tax credits of $4.8 million available to reduce the income taxes of future years through 1992.

11. Lease commitments

Future lease commitments under operating leases with terms of more than one year are as follows:

(All dollar amounts are stated in thousands)

1986	$ 2,076
1987	793
1988	308
1989	178
1990	107
Subsequent years	2,198
	$ 5,660

12. Contingencies

Litigation

On May 30, 1983, the Company filed suit in the Province of Quebec against Avco Corporation of Greenwich, Connecticut, U.S.A. for damages in the amount of $109.6 million. The Company's suit alleges a failure by Avco to fulfill contract obligations involving the development, manufacturing and delivery of engines for the Challenger 600 aircraft. On August 3, 1983, Avco filed suit against the Company in the State of Connecticut claiming U.S. $100 million on the basis of the Company's alleged unilateral termination of the Challenger 600 engine contract, non-payment of monies owed and damages to Avco's reputation. In addition, Avco claimed unspecified punitive damages. On December 21, 1983, the Company amended its action against Avco, increasing the damages claimed to $480 million.

In June 1985, a U.S. antitrust action was filed against nine aerospace companies, including Canadair Challenger Inc., a subsidiary of the Company, by certain American private plaintiffs. The action seeks treble damages of U.S. $52.5 million, alleging price fixing, production rate and other conspiracies, and combinations among general aviation manufacturers and sellers causing them damages. The Company considers the action to be without merit and is defending the suit.

The Company is a defendant in other legal proceedings which management believes are either without merit, covered by insurance, or are adequately provided for in the financial statements.

Management believes that recorded provisions for such proceedings where those have been considered necessary are adequate and the resolution of these items will not have a material adverse effect on the financial position of the Company.

Conditional repurchase agreement

In certain specified circumstances or on the happening of certain specified events, owners of a total of eight Challenger aircraft have the right to require the Company to repurchase their aircraft. Management considers it to be unlikely that the specified circumstances or specified events will materialize.

Provisions for claims

Reductions in 1982 and 1983 in the production rate of the Challenger program resulted in reduced requirements for parts and materials. Suppliers of some of those parts and materials have submitted claims for recovery of increased costs attributable to reduced rates of production and delivery. The Company has made provision for all such claims; however, because of the complexity of negotiations and the many variables involved, the Company's liability with respect to such suppliers' claims cannot yet be quantified with precision. The ultimate settlement with the suppliers could be greater or less than the amount provided, and accordingly, adjustments to the provisions may be required.

The Company has accrued for all other known liabilities, using estimates where applicable.

Repayment of government assistance

The Company is contingently liable to repay $39.2 million of government assistance (1984 – $40.3 million), based on revenues or profits from future sales. All repayments will be charged to cost of sales in the year the revenues or profits are recorded.

13. Government assistance

In 1985, assistance from the Government of Canada under established Government programs to finance production programs, development programs and equipment acquisitions amounted to $6.2 million (1984 — $4.0 million). The amount of the assistance has been accounted for as follows:

(All dollar amounts are stated in thousands)	1985	1984
Production Programs		
Credited to program cost or to sales	**$ 2,007**	$ 3,964
Development Programs		
Credited to sales	**3,883**	—
Equipment Acquisitions		
Reduction in equipment costs	**298**	—
	$ 6,188	$ 3,964

Repayment of government assistance under certain contracts is included in long term debt (note 6); other assistance is contingently repayable from future program sales (note 12).

14. Remuneration of sales and technical representatives

During the year, remuneration and expenses paid to the following sales and technical representatives in connection with foreign sales, including payments made for operational services, aggregated $0.7 million (1984 — $1.9 million):

Avionic, Greece; Compagnia Importazioni Exportazioni Rappresentage, Italy; Dismatica Industrial CA, Venezuela; Djaneast, Yugoslavia; Estudios Technologicos S.L., Spain; Hing Lung Hong, China; S. Kittivat R.O.P., Thailand.

15. Directors and officers remuneration

Remuneration paid by the Company during 1985 to the directors and to the officers was as follows:

(All dollar amounts are stated in thousands)	Directors Fees	Salaries and Benefits	Total
Remuneration of 20 present & former directors	$ 113.8	–	$ 113.8
Remuneration of 14 officers	–	$ 1,810.5	1,810.5
	$ 113.8	$ 1,810.5	$ 1,924.3

During 1985, the President was paid by Canada Development Investment Corporation and received no remuneration from the Company.

The salaried employees of the Company may contribute, on an optional basis, to the Employees' Savings & Investment Plan. The Company also contributes to the Plan a certain percentage of the employees' contributions, which amounts become vested after a period of three years. Amounts contributed by the Company during the year for the fourteen officers aggregated $96,929.

16. Pension plans

The Company's pension plans cover most employees. Pension costs incurred in 1985 and 1984 including the funding of liabilities resulting from the most recent plan amendments and actuarial reviews, did not exceed the accumulated surpluses of the plans: consequently, no contribution was required by the Company in 1985 and 1984. The latest actuarial valuation was as of December 31, 1984.

Summary of Financial Results for the Last Five Years
Year Ended December 31, 1985

CANADAIR LIMITED

(All dollar amounts are stated in thousands)	**1985**	1984	1983	1982	1981
For the year					
Export sales	**$241,042**	$313,394	$ 342,796	$ 371,398	$ 233,693
Domestic sales	**196,968**	63,049	44,340	57,981	51,969
Total sales	**$438,010**	$376,443	$ 387,136	$ 429,379	$ 285,662
Net profit (loss)	**$ 27,574**	$ 6,044	$ (184,516)	$ (1,011,852)	$ 3,035
At end of year					
Fixed assets	**$ 51,962**	$ 54,715	$ 54,920	$ 58,179	$ 55,801
Long term debt	**$ 13,131**	$ 14,426	$ 15,698	$ 10,258	$ 10,670
Number of employees	**4,667**	4,570	4,315	5,534	6,959

THE DE HAVILLAND AIRCRAFT OF CANADA, LIMITED

To the Shareholders of
The de Havilland Aircraft of Canada, Limited:

We have examined the consolidated balance sheet of The de Havilland Aircraft of Canada, Limited as of December 31, 1985, and the consolidated statements of loss and deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements present fairly the financial position of The de Havilland Aircraft of Canada, Limited as of December 31, 1985, and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

We further report that, in our opinion, the transactions of the Company which have come to our notice were in accordance with the Financial Administration Act, the regulations, the charter, and the by-laws of the Company and any directive given to the Company.

Arthur Andersen & Co.
Chartered Accountants
Toronto, Ontario

February 10, 1986

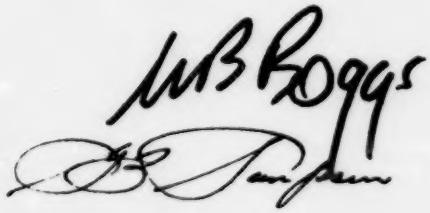
Consolidated Balance Sheet
As of December 31, 1985

THE DE HAVILLAND AIRCRAFT OF CANADA, LIMITED

(With comparative figures for the preceding year)

(All dollar amounts are stated in thousands)	**1985**	1984 (note 20)
Assets		
Current assets:		
Cash and short-term deposits (note 4)	**$ 39,329**	$ 21,150
Accounts receivable (note 5)	**25,878**	15,175
Notes receivable	**—**	237
Inventories (note 6)	**237,020**	144,990
Prepaid expenses	**1,079**	220
	303,306	181,772
Property, plant and equipment (note 7)	**42,506**	44,758
	$ 345,812	$ 226,530

Approved on behalf of the Board:



Director

Director

The accompanying notes to the consolidated financial statements are an integral part of this consolidated balance sheet.

Consolidated Balance Sheet
As of December 31, 1985

THE DE HAVILLAND AIRCRAFT OF CANADA, LIMITED

(With comparative figures for the preceding year)

(All dollar amounts are stated in thousands)	**1985**	1984 (note 20)
Liabilities		
Current liabilities:		
Bank indebtedness	**$ 979**	$ 430
Accounts payable	**51,062**	26,053
Accrued charges and provisions	**109,191**	108,629
Deposits on sales contracts	**39,528**	15,981
	200,760	151,093
Long-term debt (note 8)	**18,379**	54,333
Deferred income taxes	**17**	22
	219,156	205,448
Contingencies (notes 1(a) and 16)		
Shareholders' equity		
Share capital (note 9) —		
Authorized (unlimited number):		
Class A shares without par value		
Class B common shares without par value		
Issued:		
32,000 Class A shares and 10,000 Class B common shares	**306**	306
Contributed surplus (note 10)	**700,000**	500,000
Deficit	**(573,650)**	(479,224)
	126,656	21,082
	$ 345,812	$ 226,530

The accompanying notes to the consolidated financial statements are an integral part of this consolidated balance sheet.

Consolidated Statement of Loss and Deficit
For the year ended December 31, 1985

THE DE HAVILLAND AIRCRAFT OF CANADA, LIMITED

(With comparative figures for the preceding year)

(All dollar amounts are stated in thousands)	**1985**	1984 (note 20)
Sales	**$ 299,613**	$ 204,001
Expenses		
Cost of products and services	**233,924**	158,164
Selling and general administration	**42,433**	30,555
Sustaining development and research	**3,944**	3,919
	280,301	192,638
Income from operations	**19,312**	11,363
Dash 8 development and excess production costs (note 3)	**114,724**	78,075
Net interest (income) expense	**(810)**	9,878
Loss before scientific research tax credit transfer and income taxes	**(94,602)**	(76,590)
Scientific research tax credit transfer (note 13)	**—**	36,417
Loss before income taxes	**(94,602)**	(40,173)
Income taxes (recovery)	**(176)**	204
Net loss	**(94,426)**	(40,377)
Deficit, beginning of year	**(479,224)**	(438,847)
Deficit, end of year	**$ (573,650)**	$ (479,224)

The accompanying notes to the consolidated financial statements are an integral part of this statement.

Consolidated Statement of Changes in Financial Position (Note 1(a))
For the year ended December 31, 1985

THE DE HAVILLAND AIRCRAFT OF CANADA, LIMITED

(With comparative figures for the preceding year)

(All dollar amounts are stated in thousands)	1985	1984 (note 20)
Sources of funds:		
Increase in accounts payable, accrued charges and provisions	**$ 25,566**	$ 8,879
Increase in contributed surplus (note 10)	**200,000**	240,000
Increase in long-term debt	**—**	39,000
Decrease (increase) in notes receivable	**237**	(107)
Increase (decrease) in deposits on sales contracts	**23,547**	(2,308)
	249,350	285,464
Uses of funds:		
In operations —		
Net loss	**94,426**	40,377
Adjustments for non-cash items —		
Depreciation	**(4,536)**	(4,389)
Building written off	**—**	(3,825)
	89,890	32,163
Increase in accounts receivable	**10,703**	1,690
Additions to property, plant and equipment	**2,284**	867
Repayment of long-term debt	**35,954**	270,557
Increase (decrease) in inventories	**92,030**	(38,679)
Increase (decrease) in prepaid expenses	**859**	(1,215)
	231,720	265,383
Net increase in funds	**$ 17,630**	$ 20,081

The accompanying notes to the consolidated financial statements are an integral part of this statement.

1. Summary of significant accounting policies

The consolidated financial statements, have been prepared in accordance with accounting principles generally accepted in Canada, and reflect the following significant policies:

(a) Basis of financial statements presentation and consolidation

The consolidated financial statements have been prepared on the basis that the Company will continue as a going concern. The realization of the carrying value of the recorded assets is dependent upon the success of the future operations. See note 2 for acquisition of the Company by The Boeing Company.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, De Havilland Canada, Inc.

The consolidated financial statements have been prepared in accordance with the provisions of the Financial Administration Act.

The Consolidated Statement of Changes in Financial Position defines funds as cash and short-term deposits less bank indebtedness.

(b) Nature of business

The Company is engaged primarily in the business of development, manufacture, and sale of aircraft and spare parts.

(c) Inventories

Inventories are stated as follows:

Raw materials — at the lower of average cost and net realizable value.

Work-in-progress, new and used aircraft, spare parts, goods in transit, and sub-contract progress payments — at the lower of cost and net realizable value.

All inventories, net of customer progress payments, and including that portion not expected to be realized within one year, are included in current assets.

(d) Program accounting

With respect to new programs, the cost of each aircraft sale and inventories of work-in-progress and finished aircraft is determined using the program average production cost method. The cost of sale for a particular aircraft delivered is computed at the percentage of the published selling price that the total of the estimated production costs for the entire aircraft program bears to the total estimated sales prices for the total program. This same method is used in establishing costs for inventory purposes for completed aircraft and those in process of manufacture.

Production costs incurred early in a program, which are greater than the estimated program average production costs, are transferred to deferred charges. These deferred charges, together with deferred development and tooling costs, are amortized over the estimated breakeven number of aircraft (see note 3).

Such deferred charges are periodically reviewed throughout the life of the respective programs and adjusted to estimated net realizable value if necessary.

(e) Property, plant and equipment

Property, plant and equipment are stated at cost. When the cost of an individual asset exceeds $1,000 and deposits or progress payments are made during the period of construction or purchase, interest is capitalized at the cost of corporate borrowings. Depreciation is provided for on a straight-line basis so as to amortize the cost of depreciable assets over their estimated useful lives.

(f) Revenue recognition

(i) Revenue from aircraft sales is recorded upon acceptance and payment in full for the aircraft by the customer.

(ii) The Company undertakes some research and development under contract which provides for the company to bill the customers as costs are incurred; such amounts are recorded as sales.

(g) Translation of foreign currencies

Foreign currencies are translated into Canadian dollars as follows:

(i) Monetary assets and monetary liabilities — at the rate of exchange prevailing at the balance sheet date.

(ii) Other assets and liabilities, sales and expenses — at a rate approximating the rate of exchange prevailing on the dates of the transactions.

(h) Pensions

The Company has a number of retirement plans covering substantially all of its employees. Costs of these plans are charged to earnings and funded on the basis of actuarial calculations made every three years. Current service costs are charged to earnings on a current basis. Past service costs are being funded and charged to earnings over periods up to 15 years from the dates such costs are established.

2. Subsequent event

On January 31, 1986 the Government of Canada entered into an agreement pursuant to which The Boeing Company acquired from Canada Development Investment Corporation, 31,999 Class A shares and 10,000 Class B common shares of the Company's issued share capital.

3. Deferred charges

Certain costs applicable to the Dash 8 are deferrable depending upon long-term forecasts of sales and costs in which assumptions are made as to expected sales volumes, prices and production costs, and taking into account such factors as interest rates and exchange rates. Many of the components of these forecasts are beyond the Company's control and hence cannot be quantified with sufficient precision to project reasonably the long-term position of the Dash 8 program. Accordingly, all deferrable charges incurred in the year ended December 31, 1985 amounting to $114,724 (1984 — $78,075) have been expensed.

4. Cash and short-term deposits

Included in cash and short-term deposits are deposits totalling $240 (1984 — $485) which are assigned as security for amounts owing to a commercial bank by the Company's customers and prospective customers.

5. Accounts receivable

	1985	1984
Trade	**$ 16,839**	$ 11,615
Other	**9,039**	3,560
	$ 25,878	$ 15,175

6. Inventories

	1985	1984
Raw materials	**$ 54,352**	$ 21,414
Work-in-progress	**161,872**	91,097
New and used aircraft	**49,406**	39,579
Spare parts	**21,228**	16,932
Goods in transit	**8,886**	11,854
Sub-contract progress payments	**9,458**	11,099
	305,202	191,975
Customer progress payments	**(68,182)**	(46,985)
	$ 237,020	$ 144,990

7. Property, plant and equipment

	1985			1984	
	Cost	Accumulated Depreciation	Net Book Value	Net Book Value	Depreciation Rates
Land	$ 10	$ —	$ 10	$ 10	
Buildings	44,039	13,856	30,183	31,712	4%
Property improvements	3,090	1,028	2,062	2,163	4%
Machinery and equipment	31,020	20,933	10,087	10,751	12½-20%
Transportation equipment	1,188	1,024	164	122	25%
	$79,347	$36,841	$42,506	$44,758	

8. Long-term debt

Borrowings under extendable term loans guaranteed by the Government of Canada amount to $7,669. At December 31, 1985 the Government of Canada retained the authority to guarantee certain financial arrangements of the Company with financial institutions to a maximum of $450,000. The borrowings bear interest at rates which fluctuate with bank prime and money market rates that approximated 10% per annum at December 31, 1985. The balance of $10,710 represents a U.S. denominated loan in the amount of U.S. $7,659 bearing interest at a rate of 8 1/2% per annum, repayable in eight equal semi-annual installments commencing March 1987.

9. Share capital

Each Class A share is equivalent to each Class B common share in all respects, except that each Class A share is entitled to a non-cumulative preferential dividend of $2 in any year in which dividends are paid on Class B common shares. After payment of such dividends, both classes of shares participate fully in other dividends.

10. Contributed Surplus

During 1985, the Government of Canada contributed $200,000 (1984 — $240,000) to the Company's equity.

11. Export Sales

Sales to foreign customers amounted to $242,393 (1984 — $188,879).

12. Income Taxes

At December 31, 1985, losses carried forward for tax purposes aggregate $220,552. These losses expire as follows:

1987	$ 56,402
1990	67,736
1991	40,957
1992	55,457
	$220,552

These losses carried forward for tax purposes have been amended to reflect a reassessment.

In addition, the Company has recorded depreciation in excess of capital cost allowance claimed for tax purposes of approximately $106,000 and has deferred research and development expenses of approximately $147,000.

The Company has investment tax credits available for tax purposes of $15,054 that expire as follows:

1986	$ 4,809
1987	3,366
1990	2,109
1991	59
1992	4,711
	$ 15,054

The Boeing sale agreement restricts the utilization of certain of the above items for tax purposes (see note 2). No recognition has been given in these consolidated financial statements to the potential tax savings which could result from the utilization of the above items.

13. Scientific research tax credits

On February 28, 1984, the Company transferred to third parties scientific research tax credits relating to the period April 21, 1983 to December 31, 1984. This has resulted in net proceeds to the Company of $36,417 of which $19,685 related to 1984.

14. Pension plan

The estimated present value of the unfunded past service costs, including pension plan improvements made during 1985, not charged to earnings at December 31, 1985 amounts to $23,889 of which $11,219 is vested.

15. Commitments

(a) Lease commitments

Lease commitments under operating leases with terms of more than one year total $362 and are payable as follows:

1986	$ 313
1987	44
1988	5
	$ 362

(b) Capital commitments

Capital expenditures committed but not expended as at December 31, 1985, amount to approximately $4,064.

(c) Purchase commitments

The nature of the Company's business requires that it make substantial purchase commitments in anticipation of production and sales of aircraft. At December 31, 1985, such commitments amounted to approximately $469,000.

Under an agreement for sale and repurchase, the Company has sold engines to a financial institution at cost with an obligation to repurchase the engines in the future. The Company is charged interest at bank prime on the total commitment.

	1985	1986
Repurchase commitment	**$8,151**	$9,662
Interest expense	**$ 929**	$1,228

16. Contingencies

(a) As indicated in Note 3, the ultimate results of the Dash 8 program cannot be determined at this time. If future program assessments indicate that a future loss on the overall program will arise, a provision will be made at that time.

(b) Some suppliers with whom the Company has purchase commitments have filed claims for costs resulting from revised production schedules. The Company has made provision for costs which may be incurred in settling these claims. However, because of the complexity of negotiations and the many variables involved, some of which depend on future events, any liability with respect to such suppliers' claims cannot be quantified with precision.

(c) Contingent liabilities arising primarily from sales related guarantee arrangements and conditional repurchase agreements amount to approximately $56,000. The Company has recourse to transaction related assets for substantially all of these contingent liabilities.

(d) The total amount of government participation which is contingently repayable amounts to $106,987. At December 31, 1985 no provision has been made in the accounts for this contingency as repayment is dependent on future profits, sales or profitability of various programs and future reinvestment in Company research and development programs.

(e) A customer may be in a position to justify a claim against the Company arising from a representation, which may have been inaccurate, contained in an aircraft sales contract consummated in a prior period. No provision has been made for such a potential claim since legal counsel has advised that an accurate estimate cannot be made of the amount, if any, which the customer might successfully claim, but that the potential liability is up to $12,625 and, in the event of litigation, any additional award which might be permitted at the discretion of the court. Any amount ultimately paid by the Company would be treated as a prior period adjustment. Information relevant to this matter was improperly withheld from the Company, and, if that information had been available, the disclosure set out above would have appeared in the financial statements for the periods ended May 31, 1982 and December 31, 1982.

(f) The Company is engaged in various legal proceedings. The Company does not anticipate that the amounts, if any, which may be required to be paid by the Company will be material.

17. Related party transactions

The Canada Development Investment Corporation (a Crown corporation) owns all, except one, of the Company's outstanding shares. In 1985, sales of products to various Federal agencies and departments and Crown corporations amounted to $8,271 (1984 — $5,270).

Management fees paid to Canada Development Investment Corporation amounted to $1,104 (1984 — $2,208).

In 1985 the Company received $1,600 (1984 — $1,581) under various Government of Canada assistance programs.

18. Remuneration of directors and officers

	Directors' Fees	Remuneration	Bonus	Other	Total
Directors					
Number of Directors: 26*	$107	$ —	$ —	$ —	$ 107
Officers					
Number of Officers: 8	—	935	—	**125	1,060
Total	$107	$935	$ —	$125	$1,167

* Includes 2 directors who received no directors' fees.

** Includes aggregate cost of pension plan benefits paid into pension fund, and retiring allowance.

19. Commercial practice

During 1985, the Company had 75 agreements relating to marketing and sales with representatives, consultants, and distributors, to whom commissions and fees may be payable. Payments in 1985 aggregated $5,033 (1984 — $8,653) of which $1,779 was in respect to obligations incurred prior to 1985. For reasons of commercial confidentiality the Company does not publish the names of its representatives, consultants and distributors.

20. 1984 financial statements

The 1984 financial statements, which are presented for comparative purposes, were examined and reported on by Chartered Accountants other than Arthur Andersen & Co. In addition, certain amounts in these consolidated financial statements have been reclassified to conform to the current year's presentation.

Ten Year Review

(All dollar amounts are stated in thousands)

	December 1985	December 1984	December 1983	December 1982 (7 Mos.)	May 1982	May 1981	May 1980	May 1979	May 1978	May 1977
For The Year										
Export Sales	**$242,393**	$188,879	$107,656	$144,399	$425,328	$324,737	$210,029	$157,831	$106,257	$ 96,223
Domestic Sales	**57,220**	15,122	14,081	7,189	25,127	33,430	37,938	14,696	18,517	24,847
Total Sales	**$299,613**	$204,001	$121,737	$151,588	$450,455	$358,167	$247,967	$172,527	$124,774	$121,070
Operating profit (loss)	**$ 19,312**	$ 11,363	$(39,434)	$(34,236)	$ 66,804	$ 36,291	$ 21,882	$ 12,885	$ 5,806	$ 4,422
Gross R&D expenditures	**42,668**	49,710	$87,559	53,004	63,262	31,446	20,569	15,105	19,721	28,344
Net interest expense (income)	**(810)**	9,878	29,551	35,363	64,586	29,495	21,594	11,156	4,161	(77)
Net profit (loss)	**(94,426)**	(40,377)	(236,474)	(265,159)	1,998	6,374	1,737	3,738	2,202	2,665
At End of Year										
Working Capital (deficiency)	**102,546**	30,679	55,269	153,903	(141,063)	(61,516)	49,005	74,651	84,948	50,349
Fixed assets	**42,506**	44,758	52,105	54,382	53,056	22,766	10,967	5,198	5,450	4,739
Deferred charges	**—**	—	—	—	152,945	100,068	64,937	44,899	32,416	15,579
Long-term debt	**18,379**	54,333	285,890	210,322	1,626	—	70,000	70,000	70,000	19,853
Shareholders' equity (deficit)	**126,656**	21,082	(178,541)	(2,067)	63,092	61,094	54,720	52,983	49,245	47,043
Number of employees	**4,405**	3,500	2,864	3,433	4,163	5,415	4,746	4,564	4,114	3,197
Operating Statistics										
Current ratio	**1.5**	1.2	1.4	2.5	0.7	0.8	1.4	2.1	2.4	2.5
Debt/equity ratio	**0.1**	2.6	—	—	4.5	2.6	2.2	1.8	1.9	0.5
Return on capital employed	**—**	—	—	—	0.7%	3.2%	1.1%	2.5%	2.1%	4.0%

ELDORADO NUCLEAR LIMITED

To the Shareholder:

We have examined the statement of consolidated financial position of Eldorado Nuclear Limited as at December 31, 1985 and the statements of consolidated earnings and retained earnings and changes in consolidated financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Further, in our opinion, the transactions of the Company that have come to our notice during our examination of the consolidated financial statements have, in all significant respects, been in accordance with the Financial Administration Act and regulations, and the charters and by-laws of the Company.

The financial statements of the preceding year were examined by other Chartered Accountants.

Clarkson Gordon
Chartered Accountants
Ottawa, Ontario
February 5, 1986

Statement of Consolidated Financial Position
As at December 31, 1985

ELDORADO NUCLEAR LIMITED

(All dollar amounts are stated in thousands)	1985	1984
Current assets		
Cash and short-term investments	**$ 40,480**	$ 5,779
Accounts receivable	**12,855**	44,017
Income taxes receivable	**6,435**	11,872
Inventories	**55,284**	103,497
Supplies and prepaid expenses	**11,872**	11,321
	126,926	176,486
Current liabilities		
Bank loans and short-term debt	**106**	20,000
Accounts payable	**64,526**	67,161
Long-term debt due within one year	**79,968**	—
	144,600	87,161
Working capital (deficiency)	**(17,674)**	89,325
Non-current assets		
Property and equipment	**798,428**	795,141
Deferred charges	**28,597**	23,267
Inventory committed under long-term contracts	**29,306**	—
Other assets	**3,349**	3,471
	859,680	821,879
Capital employed	**$842,006**	$911,204
Represented by:		
Long-term debt	**513,471**	577,360
Advances under long-term contracts	**52,490**	—
Other liabilities	**3,510**	5,551
Provision for reclamation	**24,031**	22,585
Minority shareholding in a subsidiary	**43,500**	43,500
	637,002	648,996
Shareholder's equity		
Share capital	**296,586**	296,586
Retained earnings (deficit)	**(91,582)**	(34,378)
	205,004	262,208
Total financing of capital	**$ 842,006**	$ 911,204

(See accompanying notes)
Approved by the Board of Directors.

Director

Director

Statement of Consolidated Earnings and Retained Earnings
For the year ended December 31, 1985

ELDORADO NUCLEAR LIMITED

(All dollar amounts are stated in thousands)	**1985**	1984
Revenue		
Sales of products and services	**$ 219,792**	$ 208,139
Expenses		
Cost of products and services sold	**139,781**	127,168
Exploration	**5,796**	5,779
Research and development	**2,649**	2,822
Administration	**7,520**	8,209
Total operating expenses	**155,746**	143,978
Earnings from operations	**64,046**	64,161
Financing expense	**73,126**	52,316
Other expense (income)	**19,344**	(1,296)
Earnings before taxes and other items	**(28,424)**	13,141
Income taxes and mineral royalties	**24,430**	16,595
Distribution to preferred shareholders of a subsidiary	**4,350**	3,119
Earnings (loss) before extraordinary item	**(57,204)**	(6,573)
Reduction of provision for mine shutdown	**—**	11,000
Net earnings (loss)	**(57,204)**	4,427
Retained earnings (deficit) — beginning of year	**(34,378)**	(38,805)
Retained earnings (deficit) — end of year	**$ (91,582)**	$ (34,378)

(See accompanying notes)

Statement of Changes in Consolidated Financial Position
For the year ended December 31, 1985

ELDORADO NUCLEAR LIMITED

(All dollar amounts are stated in thousands)	**1985**	1984
Operating activities		
Cash received from sales	**$ 252,674**	$ 205,623
Advances under long-term contracts	**52,490**	—
	305,164	205,623
Cash applied to:		
Production costs	**91,754**	93,738
R&D, exploration & administration	**15,357**	15,980
Mineral royalties	**23,374**	16,595
	130,485	126,313
Cash provided from operations	**174,679**	79,310
Financing activities		
Cash received from:		
Income on investments	**1,025**	630
New long-term debt	**—**	125,071
Sale of royalty interest	**—**	5,000
Sale of R&D tax credits	**—**	2,485
	1,025	133,186
Cash applied to:		
Repayment of long-term debt	**—**	70,000
Net change in short-term debt	**19,894**	18,108
Interest on debt	**76,582**	65,925
Distribution to preferred shareholders	**4,350**	3,119
	100,826	157,152
Cash required for financing	**99,801**	23,966
Total cash provided from operations and external financing	**74,878**	55,344
Investing activities		
Cash received from:		
Prior year income tax overpayment	**8,312**	14,299
Sale of equipment	**782**	1,582
	9,094	15,881
Cash applied to:		
Additions to property and equipment	**38,962**	49,785
Additions to deferred charges	**6,754**	7,137
Mine shutdown	**3,555**	3,533
Purchase of net profits interest	**—**	5,000
	49,271	65,455
Cash required for investment	**40,177**	49,574
Increase during the year	**34,701**	5,770
Cash and short-term investments at beginning of year	**5,779**	9
Cash and short-term investments at end of year	**$ 40,480**	$ 5,779

(See accompanying notes)

ELDORADO NUCLEAR LIMITED

1. Eldorado Nuclear Limited

Eldorado Nuclear Limited is incorporated under the Canada Business Corporations Act, is subject to the Financial Administration Act, the Government Companies Operation Act, is an agent of Her Majesty in Right of Canada, and is wholly-owned by Canada Development Investment Corporation (CDIC).

The Company is primarily engaged in the mining, refining and conversion of uranium for sale as fuel for generating electricity in nuclear power reactors in Canada and other countries.

2. Accounting policies

A statement of significant accounting policies of the Company is provided elsewhere herein.

3. Other expense (income)

(All dollar amounts are stated in thousands)	**1985**	1984
Loss on foreign exchange	**$ 14,110**	$ 2,241
Write-down of fixed assets	**6,411**	—
Interest on investments	**(459)**	(630)
Other	**(718)**	(422)
Sale of R&D tax credits	**—**	(2,485)
Total	**$ 19,344**	$ (1,296)

4. Income taxes and mineral royalties

The provisions for income taxes and mineral royalties are as follows:

(All dollar amounts are stated in thousands)	1985	1984
Income taxes	$ —	$ —
Mineral royalties	24,430	16,595
Total	$ 24,430	$ 16,595

The reconciliation between the statutory income tax rate and the Company's effective rate of income tax is as follows:

Percentage of pre-tax earnings	1985	1984
Statutory income tax (recovery) rate	(51.9)%	50.9%
Resource and depletion allowances	(18.9)	(68.7)
Adjusted income tax (recovery) rate	(70.8)	(17.8)
Inventory allowance	(5.9)	(13.3)
Increase in unrecorded income tax debits	76.5	31.1
Effective income tax rate	0.0	0.0

Provincial mineral royalties, which are not deductible for federal income tax purposes, are calculated in part as a percentage of revenues. Consequently, they can fluctuate significantly from year to year.

At December 31, 1985, the Company had tax loss carry-forwards, investment tax credits and timing differences aggregating $133.2 million for which no accounting benefit has been recognized. This amount includes $107.8 million which will expire at various dates up to 1992. The balance may be carried forward indefinitely.

5. Inventories

(All dollar amounts are stated in thousands)	1985	1984
Mine concentrates	$ **39,412**	$ 78,515
Fuel services	**14,231**	23,084
Specialty metals	**1,641**	1,898
Total	$ **55,284**	$ 103,497

6. Property and equipment

(All dollar amounts are stated in thousands)	1985	1984
Mining		
Plant and equipment	$ **176,700**	$ 174,799
Mine development	**47,612**	46,485
Mineral properties	**156,460**	156,460
Under development	**98,004**	66,534
Fuel services		
Plant and equipment	**407,584**	428,431
Other	**15,050**	16,509
Total property and equipment	**901,410**	889,218
Less: accumulated depreciation and amortization	**102,982**	94,077
Net property and equipment	$ **798,428**	$ 795,141
Depreciation and amortization for year	$ **30,714**	$ 29,064

7. Joint venture activities

Through a wholly-owned subsidiary, the Company is a one-sixth partner in a joint venture mining operation at Key Lake, Saskatchewan. In accordance with the joint venture agreement, Eldorado is obligated to meet its proportionate share of the commitments of the joint venture. Other than normal operating expenditures, the Company has no outstanding commitments as at December 31, 1985.

The following amounts are included in the financial statements and represent the Company's proportionate share of the assets, liabilities, and operating expenses of the Key Lake mining joint venture:

(All dollar amounts are stated in thousands)	1985	1984
Assets	$ **93,582**	$ 92,254
Liabilities	**1,814**	1,629
Net Assets	$ **91,768**	$ 90,625
Expenses	$ **8,469**	$ 9,126

8. Deferred charges

(All dollar amounts are stated in thousands)	1985	1984
Preproduction	$ 25,431	$ 19,185
Financing costs	3,166	4,082
Total	$ 28,597	$ 23,267
Amortization for year	$ 2,354	$ 2,037

9. Long-term sales contracts

Eldorado has entered into contracts which provide for the future sale and delivery of uranium in the form of UF_6 at flexible dates over the eight year term of the contracts. The Company has sold the future sales contract to interested financing parties and has retained certain rights and obligations under all of the contracts. On the Statement of Consolidated Financial Position, the Company has segregated the inventory committed and the advances under long-term contracts which will be satisfied out of the future revenues associated with these transactions. The impact on the Statement of Consolidated Earnings and Retained Earnings will be recognized as deliveries take place.

10. Minority shareholding in a subsidiary

In April, 1984, an Eldorado subsidiary acquired all rights to and benefits in the 1970 New Continental Oil (NCO) royalty agreement from Aberford Resources Limited, Hacienda Oil & Minerals Ltd. and Oak Ridge Oil & Minerals Ltd. This agreement gives the holder a 20% interest in the profits derived from certain Athabasca basin properties held by Eldorado's Eldor Mines Division and others. Consideration was $5.0 million cash and $43.5 million redeemable preferred shares of the subsidiary company. The shares, with certain restrictions, can be redeemed between 1988 and 1994 and bear a 10% annual dividend.

As security, the three companies hold a lien on certain uranium inventory. At Eldorado's option, the lien can also be satisfied from time to time by a letter of credit. The lien covers the value of the subsidiary's redeemable preferred shares plus future dividends through to the shares' designated redemption dates. Each payment of a dividend or redemption of a share reduces the lien by a similar amount. At December 31, 1985, the Company has inventories in excess of the prescribed value.

For consideration of $5.0 million cash, Aberford Resources Limited, Hacienda Oil & Minerals Ltd. and Oak Ridge Oil & Minerals Ltd. acquired from Eldorado a royalty interest on uranium sales from certain designated properties. The royalty covers that portion of such sales in excess of a designated base selling price which is adjusted annually for inflation. During 1985, sales did not exceed the adjusted base price and no royalty was paid.

11. Long-Term Debt

(All dollar amounts are stated in thousands)	1985	1984
i) From Canada		
11.875% notes due 1986	**$ 10,093**	$ 10,093
ii) Other		
Notes due 1986, at 13.25% ($50 million U.S.)	**69,875**	66,070
Loan due 1991, at 7% (100 million Swiss francs)	**67,860**	50,800
Notes due 1988, at 9.19% (10.108 billion Japanese yen)	**70,594**	53,097
Loan due 1987-1992, at 8.8% (2 billion Japanese yen)	**13,968**	10,506
Notes due 1992, at 14.5% ($100 million U.S.)	**139,750**	132,140
Loan due 1992, at 14.25% ($44.7 million U.S.)	**62,399**	59,002
Bonds due 1992, at 8.5% (10 billion Japanese yen), with 10% of principal due in each of years 1988-1991	**69,840**	52,530
Debenture due 1988, at 11%	**30,000**	30,000
Euro notes, due 1989 to be set semi-annually at LIBOR rate ($100 million U.S.)	**139,750**	132,140
Sub-total	**674,129**	596,378
Less: Current portion of long-term debt listed above	**79,968**	—
Deferred loss on foreign exchange	**80,690**	19,018
Total	**$ 513,471**	$ 577,360

The long-term debt payments due in each of the next five years are as follows: 1986 — $80.0 million; 1987 — $1.4 million; 1988 — $110.4 million; 1989 — $149.5 million; 1990 — $9.8 million. Interest on long-term debt amounted to $74.9 million (1984 — $68.3 million).

12. Share Capital

(All dollar amounts are stated in thousands)	**1985**	1984
Authorized:		
Common shares		(Unlimited number no par value)
Preference shares	**1,600,000**	1,600,000
Issued and fully paid:		
Common – 3,852,880 shares (1984 — 3,852,880)	**$ 201,586**	$ 201,586
Preference — 800,000 shares (1984 — 800,000)	**95,000**	95,000
Total	**$ 296,586**	$ 296,586

Each preference share is redeemable at the option of either party at a value of $118.75 per share and carries a non-cumulative dividend of $7.125 per annum.

13. Commitments and contingencies

a) The Company has entered into long-term leases on certain properties up to 1987 with annual rental payments averaging $385,000.

b) The Company has defined benefit pension plans covering all of its regular full-time employees.

The pension funds which are administered by independent trustees, are valued at least every three years by consulting actuaries. Based on the latest actuarial valuations at June 30, 1985 and November 1, 1984, the plans have a surplus of $14.5 million.

c) The Company maintains two sites, licensed by the Atomic Energy Control Board, for the temporary storage of waste material containing low levels of radioactivity and other materials. The final disposition of this material is the subject of active discussions among Government agencies. The company will continue to expense the ongoing maintenance costs of these sites, but will make no provision for additional costs until the responsibility for such costs are determined and can be reasonably estimated.

d) In connection with its operations, the Company is the defendant in certain litigation. While the amount of any ultimate liability cannot yet be determined, the Company is of the opinion that there will be no material adverse effect on its financial position.

14. Supplementary information

a) During 1985, the Company paid sales commissions to Marubeni Corporation, Toyomenka Canada Ltd., and Uranerzbergbau-GmbH.

b) Interest costs of $4.6 million paid in 1985 have been capitalized under property and equipment (1984 — $18.0 million).

c) During 1985, the total remuneration paid to the Company's outside directors was $93,709 (1984 — $95,500). The Company's officers received remuneration totalling $607,500 (1984 — $650,129). One officer is also a director but is not compensated for service as a member of the Board or its committees.

d) A management fee of $286,000 (1984 - $534,000) was paid to Canada Development Investment Corporation.

15. Segmented information

a) Industry Segment:
The Company is of the opinion that virtually all its sales revenues are in the industry segment identified as the nuclear fuel industry.

b) Sales:
Sales revenues, which are derived primarily from sales to foreign and domestic electric utilities, are as follows:

(All dollar amounts are stated in thousands)	**1985**	1984
Export Sales	**$ 164,806**	$ 159,297
Domestic Sales	**54,986**	48,842
Total Sales	**$ 219,792**	$ 208,139

16. Provision for mine shutdown

Established in 1981, the provision for the Beaverlodge mine shutdown represented the expected remaining cost of decommissioning and reclaiming the Beaverlodge mine site. Since then, costs related to the shutdown have been applied against the provision. The shutdown work has been completed. As a result, in 1984, the provision was reappraised with the excess, $11.0 million, being recorded as extraordinary income while the remaining liability was added to accounts payable. The related income tax of $5.6 million was set off against available income tax debits.

17. Sale of R&D tax credits

In 1984, the Company sold Scientific Research Tax Credits to an outside investor by issuing to that investor a $5.0 million debenture carrying a redemption price of approximately one-half its purchase price. The debenture was redeemed, resulting in a gain of $2.5 million.

ELDORADO NUCLEAR LIMITED

The accompanying consolidated financial statements were prepared by management in conformance with Canadian generally accepted accounting principles considered to be appropriate in the circumstances, and have been applied on a basis consistent with that of the preceding year. A summary of significant accounting policies of the Company is presented to assist the reader in interpreting the statements contained herein.

Consolidation

The consolidated financial statements include the accounts of Eldorado Nuclear Limited, its wholly-owned subsidiaries, and the Company's proportionate interest in the accounts of the Key Lake Mining joint venture.

Inventories

Inventories of mine concentrates, refined and converted products are valued at the lower of weighted average cost or net realizable value. Cost for customer-owned products is the cost of the refining and conversion processes only.

Inventories of mine concentrates are initially measured and accounted for in the financial statements when the material is sealed in containers upon completion of the milling process.

Supplies

Operating and general supplies are carried at lower of cost or market.

Property and equipment

Assets are carried at cost. Costs of additions, betterments, and renewals are capitalized. When assets are retired or sold, the resulting gains or losses are reflected in current earnings.

Maintenance and repair expenditures are charged to cost of production.

ELDORADO NUCLEAR LIMITED

Depreciation and amortization

Fuel Services and Mining buildings and equipment, mine development and mineral properties are depreciated or amortized according to the unit-of-production method. This method allocates the cost of these assets to each accounting period. For Fuel Services, the amount is equal to the portion of the facilities' total estimated lifetime production produced in that period. For Mining, the amount is equal to the portion of the mine's total recoverable ore reserves recovered during the period.

Mobile mining equipment and other assets, including R&D, Exploration, Specialty Metals, and Corporate assets, are depreciated according to the composite straight-line method based on the estimated useful lives of these assets, which ranges from 3 to 10 years.

Fuel Services and certain mining facility costs associated with capacity additions are deferred until a commercial level of production is achieved. These costs are then amortized over 10 years in the case of Fuel Services assets, and according to the unit-of-production method in the case of Mining assets. Other costs are charged to production as incurred.

Amortization of financing costs

Debt discounts and issue expenses associated with long-term financing are deferred and amortized over the term of the debt.

Capitalization of interest

Interest costs on funds borrowed to finance the development and construction of major assets are capitalized during the development and construction period until such time as a commercial level of production is achieved.

Provision for reclamation

The estimated costs of decommissioning and reclaiming producing resource properties are accrued and charged to operations according to the unit-of-production method. Actual costs of decommissioning and reclamation are applied to this accrual.

Research and development and exploration costs

Expenditures for applied research and development relative to the products and processes of the Company and expenditures for geological exploration programs are charged against earnings as incurred.

Sales of products and services

In accordance with normal industry practices, the Company contracts for future delivery of mine concentrates and conversion services. Sales revenue is recorded in the fiscal year that title passes or, with customer-owned material, when delivery is effected.

Foreign exchange

Cash and short-term investments, accounts receivable, accounts payable and long-term debt denominated in foreign currencies are translated into Canadian dollars at rates of exchange in effect at year-end. Income and expenses are translated at rates in effect at the time of the transaction.

Except for certain U.S. dollar-denominated long-term debt that is hedged against future U.S. dollar revenue, the change in value in Canadian funds over the year of long-term debt denominated in a foreign currency is amortized evenly over the remaining life of the debt. For all other accounts, gains or losses resulting from foreign currency translation are reflected in the statement of consolidated earnings and retained earnings.

10-Year Summary of Operations

(All dollar amounts are stated in thousands)

	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976
Income and Expenses										
Revenue	$219,792	$208,139	$154,047	$ 88,818	$ 71,888	$ 91,116	$111,498	$124,046	$ 68,623	$ 47,708
Gross profit (loss)	80,011	80,971	51,244	31,008	(5,029)	24,259	22,229	38,718	27,460	12,612
Operating profit (loss)	64,046	64,161	36,709	16,452	(18,632)	10,920	7,800	28,105	15,662	5,113
Provincial royalties	24,430	16,595	8,419	3,886	1,003	2,070	4,200	3,218	3,779	
Net earnings (loss)	(57,204)	4,427	9,958	3,592	(128,817)	2,668	674	17,618	6,933	3,073
Financial Position at Year End										
Cash provided from operations	$174,679	$ 79,310	$ 17,084	$ (1,407)	$(31,725)	$ 6,590				
Working capital (deficiency)	(17,674)	89,325	(6,883)	184,035	(33,301)	(8,310)	$ 18,376	$ 8,381	$ 66,941	$ 57,639
Net property and equipment	798,428	795,141	504,715	376,843	163,304	170,232	132,778	85,013	54,940	41,113
Total assets	986,606	998,365	915,204	878,556	620,530	360,557	326,241	314,882	183,775	125,613
Long-term debt	513,471	577,360	439,956	460,201	265,923	204,990	183,093	130,366	96,414	59,272
Shareholder's equity	205,004	262,208	257,781	257,823	254,231	83,048	80,380	79,706	62,088	55,155
Capital Outlays										
Capital expenditures	$ 50,177	$ 77,325	$137,115	$239,862	$ 75,111	$ 53,949	$ 56,296	$ 38,196	$ 20,063	$ 16,201
Of which capitalized interest is	4,568	17,982	30,304	18,379	8,501	2,790				
Depreciation and amortization	32,152	30,209	15,657	9,895	16,881	14,331	9,702	8,400	6,040	5,813
Significant Financial Ratios										
Gross profit margin	36.4%	38.9%	33.3%	34.0%	(7.0)%	26.6%	19.9%	31.2%	40.0%	26.4%
Operating profit margin	29.1%	30.8%	23.8%	18.5%	(25.9)%	12.0%	7.0%	22.7%	22.8%	10.7%
Return on capital employed	(6.8) %	0.5%	1.4%	0.5%	(24.7)%	0.9%	0.2%	7.8%	4.2%	2.6%
Debt to equity ratio	2.5	2.2	1.7	1.8	1.0	2.5	2.3	1.6	0.6	0.5
Interest coverage ratio	0.5	0.9	1.5	1.1	0.6	1.5	1.3	5.0	2.7	1.8
Current ratio	0.9	2.0	1.0	2.4	0.7	0.9	1.4	1.1	4.4	9.7
Selected Operating Statistics										
Number of employees at year-end	1,111	1,199	1,323	1,653	1,653	1,737	1,610	1,499	1,288	1,105
Uranium produced (tonnes U.)	1,536	2,029	1,316	375	375	423	387	493	456	457
Uranium processed (tonnes U.)	6,833	4,399	5,564	6,339	5,990	5,211	5,810	4,185	4,708	3,830

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